

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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APR 16 1997
Federal Communications Commission
Office of Secretary

In the Matter of

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Amendment of Part 1 of the
Commission's Rules --
Competitive Bidding Proceeding

WT Docket No. 97-82

To: The Commission

REPLY COMMENTS OF MERLIN TELECOM, INC.

Merlin Telecom, Inc. ("Merlin"),¹ by its attorneys, hereby replies to comments filed in response to the *Order, Memorandum Opinion and Order and Notice of Proposed Rule Making* ("Order and NPRM" or "NPRM") released by the Federal Communications Commission ("FCC" or "Commission") on February 28, 1997, in WT Docket No. 97-82.

I. Designated Entity Auction Participants Should Be Able to Avail Themselves of Both Installment Payments and Bidding Credits.

In its Comments, Merlin supported the continued availability of installment financing for licenses auctioned by the FCC. Comments filed by Pocket Communications, Inc. ("Pocket") support this position. Pocket points out, "The key financial assistance that the Commission can offer to small businesses is an installment payment plan." Pocket Comments at 4. Pocket further

¹ Merlin is a telecommunications consulting firm which is joined in filing these comments by several of its clients including: Horizon, LLC, Digitel, LLC, AirAdvantage, LLC, Clearwave, LLC and Genesis, LLC. These companies are all potential bidders in future FCC auctions.

notes that “[a]n installment payment system allows small business licensees to begin making larger payments once they are cash flow positive, at which time additional financing from the capital markets will become available.” *Id.* Merlin agrees. As Merlin pointed out throughout its Comments, the greatest obstacle that a small business faces in competing to provide telecommunications services is the capital necessary to build and operate a system to compete with other existing services. Merlin Comments at 5-8. The amounts of capital needed, particularly for a small company, can be prohibitive. For that reason, accessing capital is a vital element of entering the market to provide spectrum based services. The Commission’s original installment payment program was crafted to help small companies enter the competitive marketplace while deferring some upfront capital costs. This was a substantial benefit to smaller companies. If the FCC eliminates the installment payment program, small businesses will not be able to participate in the provision of spectrum based services. Bidding credits, especially those contemplated in the *NPRM*, are not sufficient to help small businesses initially access the capital that they will need to get started in these businesses.

As Pocket explained, installment payments “would give small business licensees the opportunity to use invested capital to develop their businesses into successful ventures, rather than meeting interest payment obligations.” Pocket Comments, at 5. Also, as Merlin and Pocket both pointed out in their respective Comments, deferring repayment to the government can make default less likely, rather than more likely, because it gives companies a chance to build and operate systems to generate a stream of income with which to make payments to the government.

In contrast, Cook Inlet Region, Inc. (“Cook Inlet”) suggests that the FCC establish the credit-worthiness of installment payment applicants. Cook Inlet Comments at 11. Merlin disagrees. The FCC should not act as a credit approval agency. The FCC has as its mission the rapid deployment of new services and the issuance of licenses to the public to use the airwaves. 47 U.S.C. §§151, 309(j). It is not charged with checking the viability of the business plans of license applicants. For years, the FCC has relied on the business acumen of qualified lending institutions, which provide financial commitments to applicants for licenses, to establish that an applicant is financially qualified to hold a license. The record provides no reason to change this practice. The FCC should not step into the shoes of the financial backers of applicants to screen them for credit-worthiness. Moreover, small and newly formed businesses would be unfairly prejudiced by such a rule because they do not have a large base of capital or track record in business to rely upon. FCC screening of the credit-worthiness of applicants would undercut its fulfillment of its mandate to ensure that licenses are disseminated to a wide variety of businesses including small businesses and businesses which have traditionally lacked access to FCC licenses such as businesses owned by minorities or women. 47 U.S.C. § 309(j). Merlin believes that the FCC should continue to rely on the financial community to play its role in evaluating the viability of businesses applying for FCC licenses.

Cook Inlet has also recommended that the FCC adopt higher bidding credits instead of government financing. Cook Inlet Comments at 11. Merlin opposes this approach. Even substantial bidding credits cannot help a small business access enough ready capital to pay for a license outright at the conclusion of an auction. The financial markets do not lend money that

speculatively. Cook Inlet seems to be seeking a way to let the FCC out of providing installment payments. However, as Merlin explained in its Comments, the FCC should continue to make installment financing available.²

Merlin also supports Pocket's argument that the FCC should not impose late payment fees when a licensee avails itself of an automatic 90-day grace period. Pocket Comments at 7. As Pocket points out, "[T]he late fees proposed by the Commission would in many cases make grace periods unavailable." *Id.* Grace periods should be automatic, without additional penalties.

II. The FCC Should Not Assess New Fees for Bid Withdrawals Nor Establish a Limit on the Number of Times an Auction Participant May Withdraw a Bid.

Merlin opposes the Personal Communications Industry Association's ("PCIA") suggestion that the Commission consider incorporating two other types of penalties. PCIA Comments at 6. PCIA suggests that an "administrative fee" be assessed against bidders who participate in an auction to drive up prices and then withdraw prior to the close of the auction.

² If an applicant submits a sound application proposing reasonable engineering, and demonstrates by making timely down payments that it has financial backing, the FCC has reasonable assurance of repayment under the installment payment program. This means that the public's interest will be protected while ensuring that small businesses have a chance to participate in the provision of spectrum based services. Moreover, as Merlin explained in its Comments, the license, if it defaults back to the government, will still be intact, ready to be auctioned again to another prospective licensee. Merlin Comments at 12. While some commenters may suggest that service will be delayed to the public by this approach, the reality is that service will reach the public faster if the FCC retains installment financing because a licensee will be able to dedicate all its initial capital resources to constructing and operating its system early in the license term.

Id. Merlin opposes this fee proposal because an indiscriminate rule does not distinguish between bidders who have acted intentionally to bid up prices and bidders who have simply made valid economic decisions that the values of licenses in the auction have gotten too high, causing those bidders to choose to withdraw from the auction. If a bidder “bids up the price of a license,” no other bidder has an obligation to bid more for the license if the other bidder believes the license to be over-valued. If the “bad actor” bidder has over-valued the license, the Commission’s current bid withdrawal and default penalties will act as a deterrent to the bad actor bidder as well as recouping for the public the cost of re-auctioning a license should it become necessary.³ It is unnecessary and unreasonable for the FCC to prospectively punish behavior by auction participants which is undertaken in good faith.

In its Comments, AT&T Wireless (“AT&T”) opposes “the imposition of limits on withdrawals or any other standardized mechanism aimed” at addressing the problem of the misuse of the ability to withdraw bids. AT&T Comments at 5. Merlin supports AT&T’s position. Each bidder needs to make strategic decisions about its bidding round by round as an auction progresses. It would be an unreasonable constraint on the market mechanism of the auction if the FCC were to impose limits on a bidder’s ability to change its bidding strategy during the auction as it learns more information about the value of licenses. Merlin agrees with AT&T that the FCC should monitor the auction and deal with any abuses of the system on a case-by-case basis.

³ If a licensee violates the FCC’s rules, the Commission may also issue a Notice of Apparent Liability for Forfeiture against that participant, on a case by case basis.

III. The FCC Should Not Adopt a Rule Under Which Default on One License Would Cause a Default on Other Licenses.

Merlin disagrees with PCIA and Cook Inlet's position on cross defaults.⁴ Cook Inlet supports cross defaults because it fears that licensees will "cherry pick" profitable licenses to hold and default on licenses which are not economically viable. This argument is shortsighted. Strategic business planning is just what the market mechanism for assigning licenses is designed to allow. After an auction, the auction winner has an ability to make business decisions about what courses of action are in its best business interests. The FCC's penalties for default -- at least three percent of the auction price of the license and forfeiture of the bidder's down payment amounts -- have deterred, and will continue to deter, speculation in the licensing process. But, if a licensee discovers that one of its markets is not viable while the others are very successful, a cross default rule could jeopardize all the licenses. As Pocket succinctly stated, "The rule is especially unfair in that it would elevate a default in one market over a licensee's success in all its other markets." Pocket Comments at 12. Merlin agrees with Pocket that a rule creating cross defaults would be bad for the public.

Cook Inlet provides no support for its argument that service would be provided more

⁴ PCIA supported a cross default policy in its comments, but it did not provide any rationale for its position. PCIA Comments at 7.

quickly to areas if there were cross-default provisions. In fact, the opposite is true. If the FCC adopts a cross default policy, the Commission will make it more likely that a licensee will fail because the rule will create a domino effect, causing any mistake by any licensee to topple each of its licenses in succession. This would lead to less service not more because licensees would be less willing to take the risks necessary to build out their systems with alacrity.

IV. The FCC's Affiliation and Attribution Rules Should Be Made Simpler and Clearer, But They Should Not Be Changed in Services Where Licenses Have Already Been Auctioned.

Merlin set out its proposals regarding the Commission's attribution and affiliation rules in its Comments. Merlin Comments at 18 -22. Merlin agrees with PCIA that "Potential bidders who have built their business cases on existing service-specific auction rules should not now be forced to change their plans . . ." PCIA Comments at 2. Many of Merlin's clients have invested time and money in structuring their businesses to comply with the Commission's Narrowband PCS rules. It would be unfair to force them to re-structure without good cause this far into the process. Merlin also agrees with Pocket that rules requiring *de facto* and *de jure* control but which permit a bidder to raise capital will help those bidders have a "meaningful opportunity to participate in the wireless market." Pocket Comments at 3. Likewise, Cook Inlet has encouraged the Commission to evaluate control of entities in such a way "that provides certainty for potential small bidders." Cook Inlet Comments at 4. Merlin supports these commenters and again encourages the Commission to set reasonable and clear attribution rules which will allow small businesses to participate in its auctions.

V. The FCC Should Not Require a Second Down Payment From an Applicant if a Petition to Deny Is Pending Against the Application.

Merlin disagrees with PCIA that all winning bidders, including designated entities, should make their second down payments at the same time, “regardless of whether petitions to deny have been filed against them.” PCIA Comments at 5, *citing NPRM* at ¶ 65. PCIA claims that simultaneous payment of second down payments will reduce potential inequities. However, there is no discussion of what those potential inequities could be. The Commission’s proposal to consider requiring all second down payments to be made at the same time is ill-conceived and without justification. As AT&T points out, “In some cases, financing may be contingent on award of a license and in other cases, the licenses may never be granted or may only be granted after protracted litigation. AT&T Comments at 4. The Commission’s proposal would tie up vital capital, or require a winning bidder to secure capital without any thing to show for it. This would significantly prejudice that winning bidder *vis a vis* licensees who have licenses and are free to construct and operate their systems. *Id.* Merlin therefore opposes any requirement that a second down payment be made before the license is granted.

VI. Merlin Opposes the Use of Combinatorial Bidding.

Automated Credit Exchange (“ACE”) filed Comments recommending that the FCC adopt package, or combinatorial, bidding for its future auctions. This is a bidding methodology which the FCC rejected three years ago as too complex and difficult to implement. ACE Comments at 2-3. According to ACE, package bidding is no longer too complex because it has developed a user-friendly system. However, ACE does not provide substantiation for why the new system is

easier for a bidder to use. ACE's testing of the new system in its academic setting does not reflect the difficulty that businesses face as they try to adapt bidding strategies to complex matrices of information. It takes a tremendous amount of time to formulate a bidding strategy in a simultaneous multiple round auction. When the added variables of package bidding are factored in, bidders would need more time, not less, to plan their bidding strategies. This would slow the auction process rather than speeding it, which is not in the public interest. Merlin notes that the theoreticians working with ACE have some of the country's most sophisticated computer equipment and a host of researchers at hand to test their bidding models. Those resources are not available to small businesses which are the most common participants in the FCC's auctions for licenses. The FCC would make a very unwise decision if it were to adopt a bidding methodology which only academicians at the cutting edge of game theory are able to master. Additionally, the pollution rights market, which was the subject of ACE's trial, is vastly different from the spectrum market: there are, *inter alia*, different dollar magnitudes, types of bidders, and geographical considerations. ACE has not presented a feasibility analysis which demonstrates that the package bidding system used in pollution rights auctions would work for the FCC. Accordingly, Merlin is opposed to the adoption of combinatorial bidding as a means of awarding licenses.

VII. Conclusion

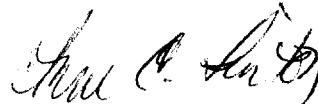
If the Commission adopts any of its or the commenters' proposals which Merlin has opposed, small businesses will face increasing barriers to their participation in offering wireless services. Consequently, the Commission will have failed to meet the mandates set out by Congress when it authorized the FCC to use competitive bidding to assign licenses.

For the foregoing reasons, Merlin respectfully requests that the Commission act in a manner consistent with the comments set forth above.

Respectfully submitted,

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April 16, 1997

Certificate of Service

I, Melissa M. Fistner, an employee in the law firm of Bennet & Bennet, PLLC, hereby certify that a copy of the foregoing Comments of Merlin Telecom, Inc. were served via first-class, U.S. postage pre-paid mail, this 16th day of April 1997 on the following:

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